

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EB:QP2-PLR-115874-00

Date:

February 16, 2001

LEGEND:

Employer =

Plan =

Dear

This is in response to your letter dated August 10, 2000, requesting a ruling on the federal tax consequences of certain specified amendments proposed to be made to the Plan. Employer is a municipality and an eligible employer within the meaning of section 457(e)(1)(A) of the Code.

The Plan is intended to be an eligible deferred compensation plan to which section 457(a) applies. Employer received a private letter ruling with respect to the Plan on September 27, 1991. The Plan was subsequently amended and Employer received a private letter ruling with respect to the Plan on January 19, 1999, to the effect that the Plan complies with section 457 as amended by the Small Business Job Protection Act of 1996.

Under the Plan an employee may elect to defer compensation he or she would have received for services rendered to the employer in any taxable year. The deferral extends until the participant reaches age 70 ½, separates from service, dies, or has an unforeseeable emergency. The election to defer compensation for any calendar month must be made before the beginning of such month. The Plan provides for a maximum amount that may be deferred by a participant in any taxable year and for a catch-up computation for amounts deferred for one or more of the participant's last three taxable years ending before normal retirement age under the Plan. The amounts that may be deferred under the annual maximum limitation and the catch-up provision are within the limitations set out in section 457 of the Code.

A Participant or his beneficiary may elect the manner in which his or her deferred amounts will be distributed. These include (1) substantially equivalent monthly, quarterly, semi-annual or annual installments, (2) partial lump-sum payment, the rest to be paid in substantially equivalent monthly, quarterly, semi-annual or annual

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installments or (3) a lump sum cash payment. The election must be made prior to the date any such amounts become payable to the Participant or the beneficiary. If the Participant fails to make a timely election concerning distribution of the deferred amounts following separation from service, payment will be made in substantially equivalent quarterly installment payments over the life expectancy of the Participant. If the beneficiary fails to make a timely election concerning distribution of the deferred amounts following the death of Participant, payment will be made in one cash lump sum within 60 days after the expiration of the period in which to make an election. The manner and time of benefit payments must meet the distribution requirements of section 401(a)(9) and 457(d)(2) of the Code.

A basic requirement prescribed by section 457(b)(5) is that an eligible section 457 plan must meet the section 457(d) distribution requirements described above in order to retain its tax-deferred eligible status. A section 457 plan would violate these provisions of section 457(b)(5) and the regulations thereunder if the participant or anyone else received a distribution earlier than the earliest date established in section 457(d)(1)(A).

The Plan, however, permits an exception to the above distribution requirements. The Plan, in accordance with section 457(e)(9)(A) of the Code, includes a provision permitting a lump sum in-service distribution of \$5,000 or less of a Participant's account during an annual *de minimis* payout period, if the Participant elects, within sixty days after receiving notice from the Plan Administrator, to receive such a distribution, or at any other time the Participant elects to receive such a distribution, provided that there has been no amount deferred by the Participant during the two year period ending on the date of distribution and there has been no prior distribution received by the Participant pursuant to section 457(e)(9)(A).

Deferrals under the Plan will be held in a custodial account, pursuant to a custodial account agreement. Amounts deferred under the Plan will be transferred to the custodian or its agent as promptly possible, but in no event later than two business days after the applicable payroll date, and will be invested promptly in accordance with the investment directions of the Participant, but in no event later than two business days following receipt of the amounts by the custodian or its agent.

The custodial account agreement provides that it shall be impossible, prior to the satisfaction of all liabilities with respect to Plan Participants and their beneficiaries, for any part of the funds of the custodial account to be used for, or diverted to purposes other than for the exclusive benefit of the Participants or their beneficiaries as provided for in the plan. It further provides that the assets of the custodial account will never inure to the benefit of the employer and will be held for the exclusive purposes of providing reasonable expenses of administering the Plan and the custodial account. No amount payable at any time under the Plan will be subject in any manner to alienation by anticipation, sale, transfer, assignment, pledge, attachment, charge, or encumbrance of any kind.

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The Plan and custodial agreement provide that all amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts and all income attributable to such amounts, property, or rights shall be held in trust for the exclusive benefit of participants and beneficiaries under the Plan.

The plan provides that no payments to an Alternate Payee pursuant to a domestic relations order may be made prior to the earliest date as of which payments to a Participant could commence under the Plan. Upon the receipt of a Plan Certified Domestic Relations Order, a portion of the Participant's account, as determined under the Plan Certified Domestic Relations Order, shall be segregated in an account maintained on behalf of the Alternate Payee.

The Plan permits Participants, Beneficiaries and Alternate Payees under Plan Certified Domestic Relations Orders to file requests for withdrawals in the case of unforeseeable emergencies based on severe financial hardships suffered by Participants, Beneficiaries or Alternate Payees. An amount is not considered to be reasonably needed to meet the financial need created by an unforeseeable emergency to the extent that the need is or may be relieved (i) through reimbursement or compensation by insurance or otherwise, (ii) by liquidation of the Participant's, Beneficiary's, or Alternate Payee's assets, to the extent the liquidation of the assets would not itself cause severe financial hardship, or (iii) by cessation of deferrals under the Plan.

Section 457 of the Code provides rules for the deferral of compensation by an individual participant in an eligible deferred compensation plan (as defined in section 457(b)).

Section 457(a) provides that in the case of a participant in an eligible deferred compensation plan, any amount of compensation deferred under the plan and any income attributable to the amounts so deferred shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or beneficiary.

Section 457(b)(5) prescribes that an eligible deferred compensation plan must meet the distribution requirements of section 457(d).

Section 457(d)(1)(A) provides that for a section 457 plan to be an eligible plan, the plan must have distribution requirements providing that under the plan amounts will not be made available to participants or beneficiaries earlier than i) the calendar year in which the participant attains age 70 ½ when the participant is separated from service with the employer, or iii) when the participant is faced with an unforeseeable emergency as determined under Treasury regulations. However, section 401(a)(9)(C)(i) generally allows plans to postpone the required beginning date until April 1 of the calendar year following the later of the calendar year in which the employee retires or in which he

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attains age 70 ½.

Section 1.457-2(h)(4) of the Income Tax Regulations defines an unforeseeable emergency as severe financial hardship to the participant resulting from a sudden and unexpected illness or accident of the participant or of a dependent, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

Section 457(g) provides that a plan maintained by an eligible governmental employer shall not be treated as an eligible deferred compensation plan unless all assets and rights purchased with such deferred compensation amounts and all income attributable to such amounts, property, or rights of the plan are held in trust for the exclusive benefit of participants and their beneficiaries. Section 457(g)(3) provides that for purposes of section 457(g), custodial accounts described in section 457(f) shall be treated as trusts.

Based upon the provisions of the Plan summarized above and provided that the Plan is amended as proposed in the draft plan language submitted on August 10, 2000, we conclude as follows:

1. The Plan continues to be an eligible deferred compensation plan as defined in section 457 of the Internal Revenue Code of 1986.
2. Amounts of compensation deferred under the Plan, including any income attributable to the deferred compensation, will be includible in gross income for the taxable year or years in which amounts are paid or otherwise made available to a Participant or a Participant's beneficiary in accordance with the terms of the Plan.
3. The custodial account established under the Plan will be treated as a trust for Purposes of 457(g).

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than the Plan described above. In addition, this ruling applies only to deferrals made after the date of this ruling.

This ruling is directed only to Employer and the participants of the Plan. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion in the ruling. See section 12.04 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1, 46.

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However, when the criteria in section 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely yours,
ROBERT D. PATCHELL
Assistant Chief, Qualified Plans Branch 2
Office of the Division Counsel/
Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosure:
Copy for 6110 purposes